

# California's Current Budget Crisis: *What Can We Learn from the Past?*



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*Nov. 18, 2004*

**“Everybody is entitled  
to my opinion.”**

*Madonna*



**“Everybody is entitled  
to my opinion.”**

*Mitchell*



**2/12/01: Hirsch and Mitchell,  
LA Times, op ed:**

*“As California’s electricity crisis unfolded, there was much talk about using the state’s “surplus” to fend off high energy costs. ... There is one problem... In the current fiscal year ending June 30, California is running a deficit. And the budget proposals for next fiscal year similarly project a deficit.”*



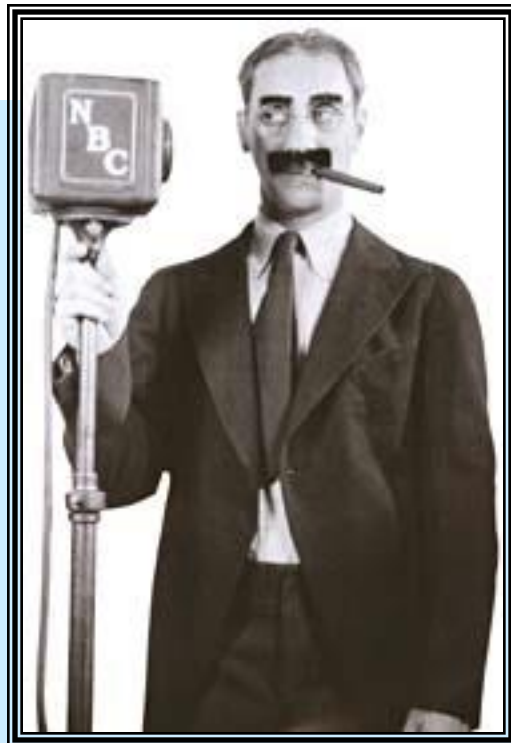
# 2/23/01: Tim Gage, State Director of Finance, LA Times, Letter to the Editor

*“The charge by (Hirsch and Mitchell) that California is running a deficit is flatly untrue.”*



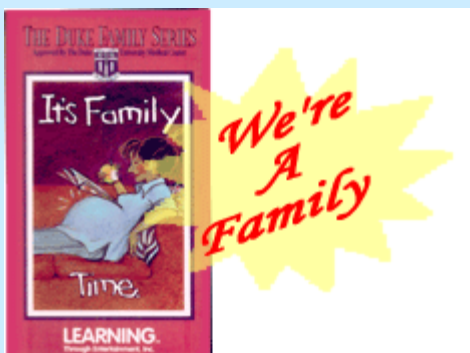
***“Who are you gonna believe? Me or your own eyes?”***

**Groucho Marx**



# 12/18/02: Tim Gage, State Director of Finance, quoted in Gov. Davis' press release announcing Gage's replacement

*“I look forward to other opportunities that will allow me to spend more time with my family.”*





- **There is a BIG budget problem**
  - **The conflict may not be where you think, i.e, in the Legislature**
  - **California's fiscal history provides some clues about the problem's location**
    - **Taxpayer revolt**
    - **Transportation projects**
    - **Other public works & services**
  - **Implications**
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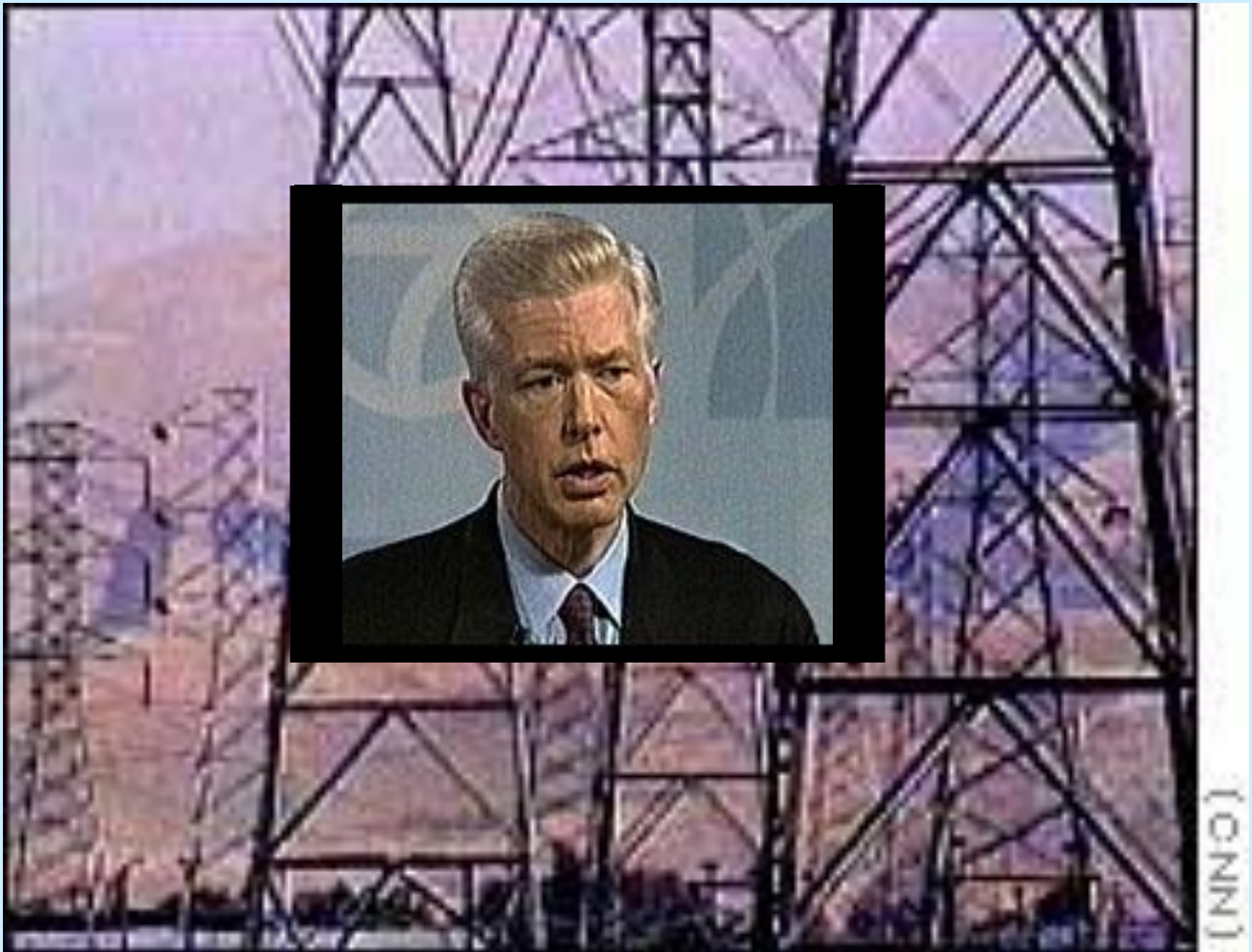
# 1999-2000: *Dawn of the Davis Era*

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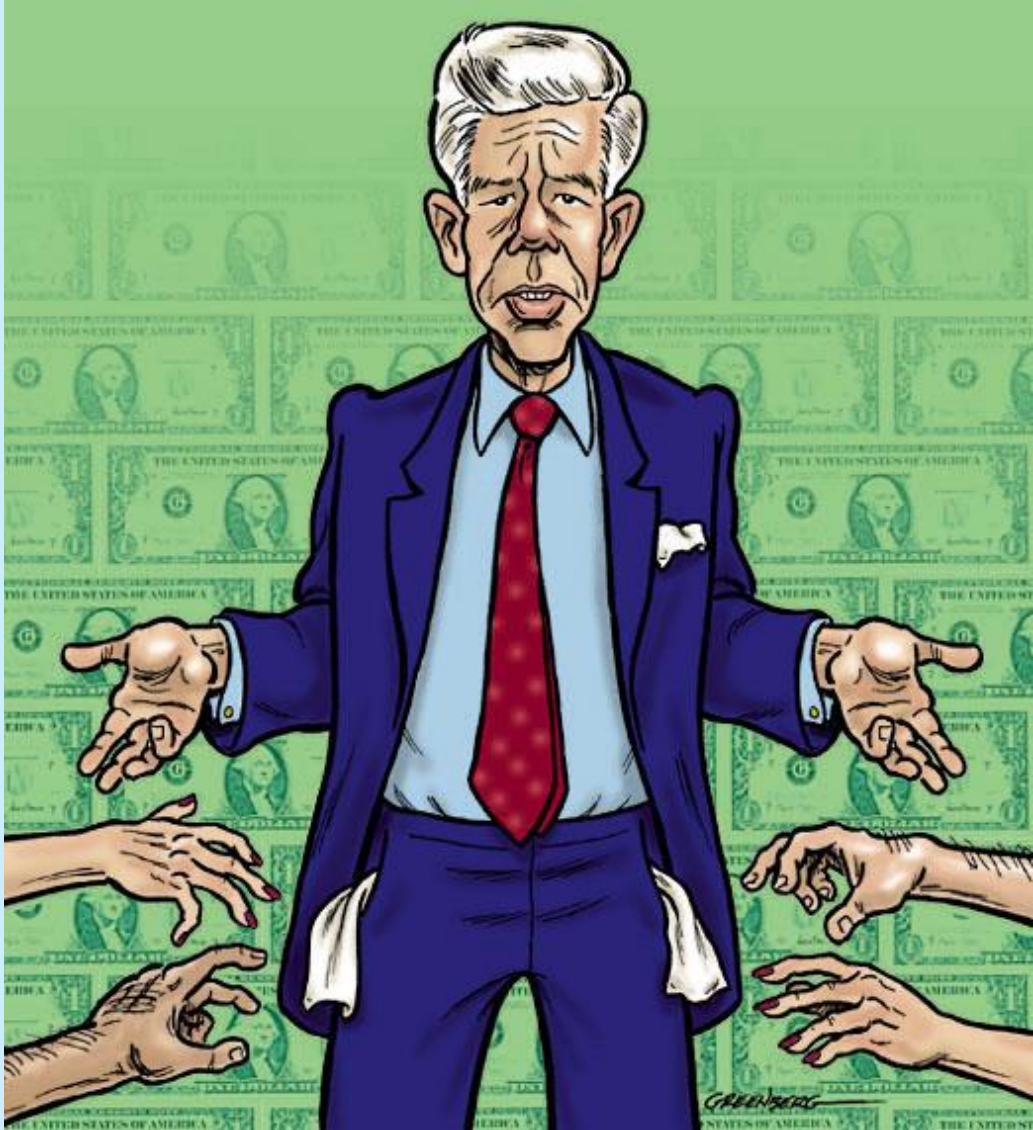
# 2001-2002: *Sunset of the Davis Era*

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# 2001-2002: *Sunset of the Davis Era*

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# John Vasconcellos

## Dem. Senator - San Jose



*“I have never been so frightened  
about California’s future as I am  
now. The ingredients seem to be  
here to take the state right over the  
cliff.”*



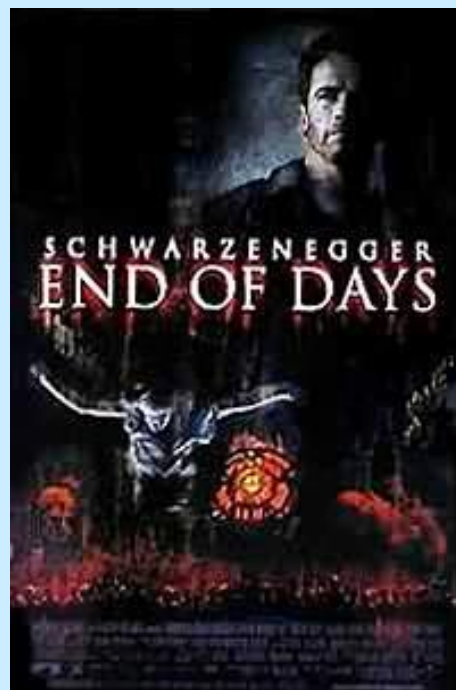
# Keith Richman Rep. Assemblyman - Northridge



*“Without bipartisan  
cooperation, we are headed for  
a fiscal train wreck.”*



# 2003: *End of the Davis Era*



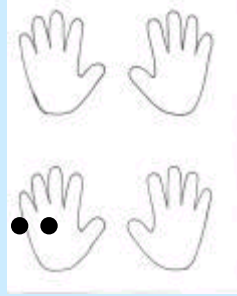


Now Available

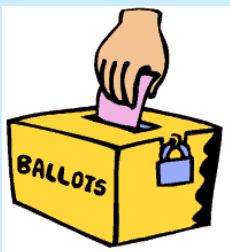
THE COMIC BOOK OF THE YEAR  
ARMAGEDDON



*Hands on approach...*



Chronicle / Michael Macor



*...with voter-approved  
borrowing*



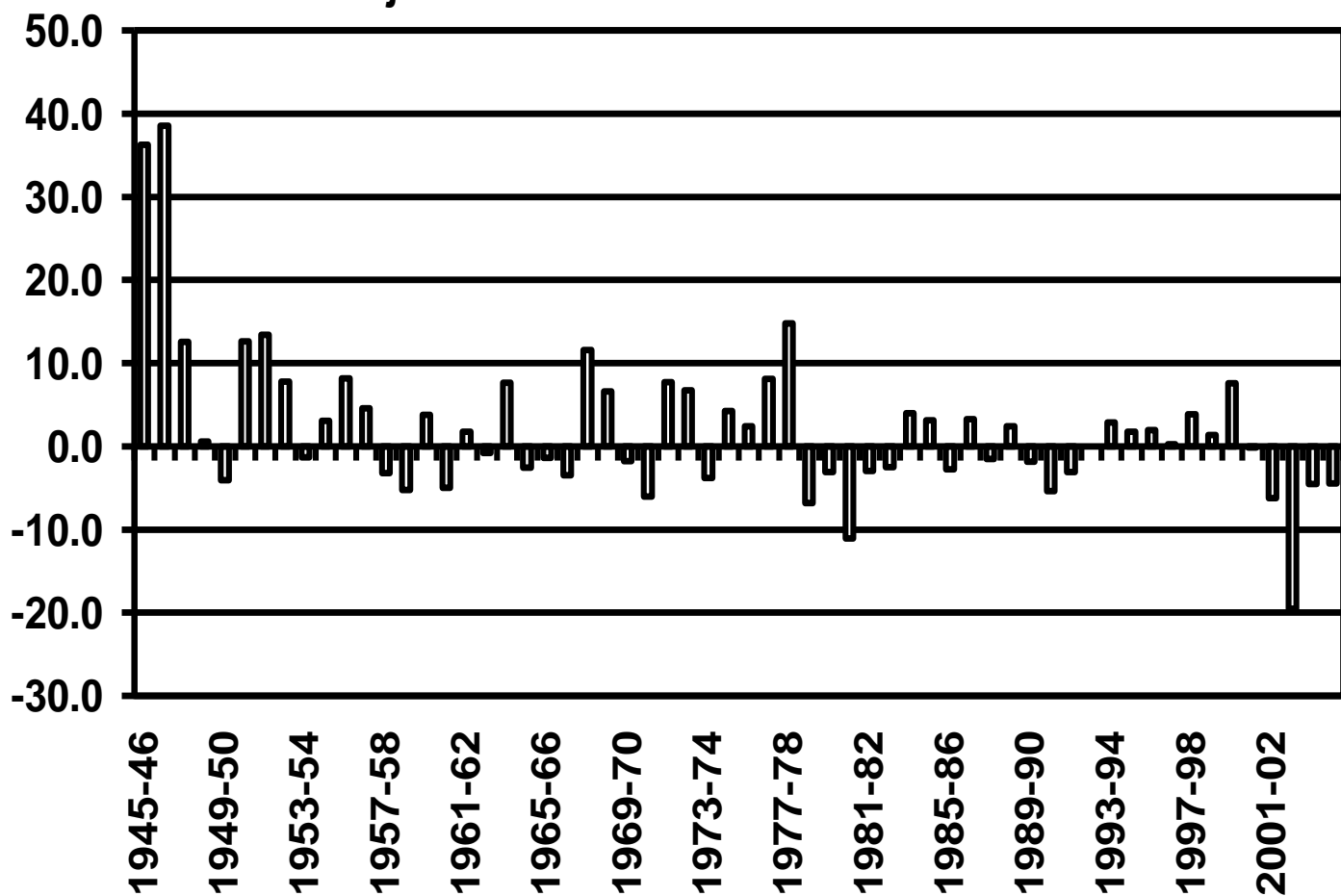


**And after passage of 57/58  
avoided Armageddon...**



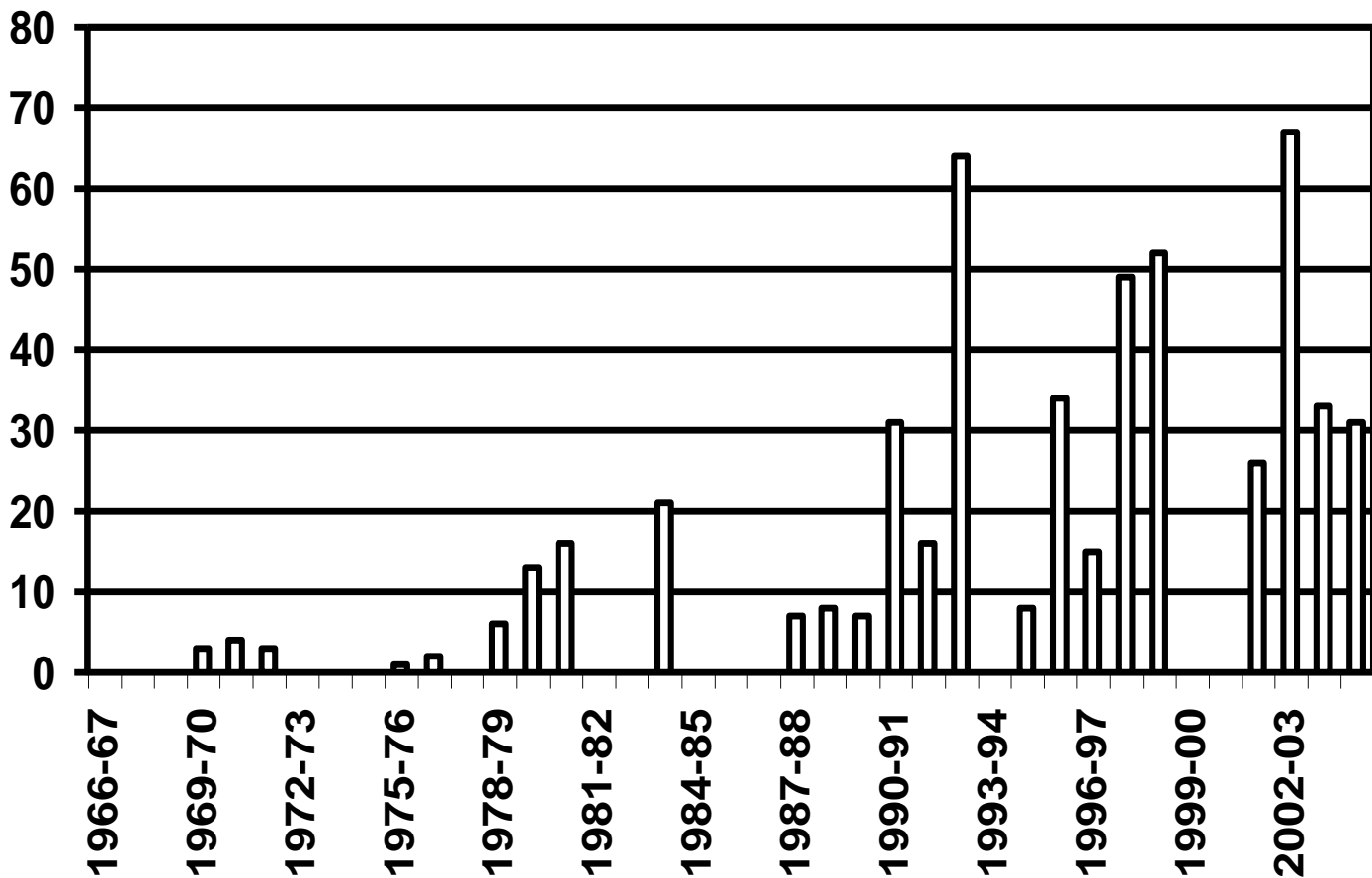
# *Budget Outcome*

Surpluses or Deficits as Percent of  
Adjusted Revenues and Transfers



# *Budget Delay*

Days of Budget Delay Beyond June 30



*"Of course we will miss the deadline, but you have to shoot for something; that's my goal. It's the same as shooting for a 500-pound lift and you make it with 495 or something like that. 'Is it disappointing? No, it's great. It's a terrific lift. No one else can do it.'"*



**Governor Arnold  
Schwarzenegger  
commenting on missing  
the June 30 deadline**

*Is this fair?*



***“You really know how to hurt a guy.”***



**Governor Arnold Schwarzenegger  
when asked whether his budget  
proposals, involving borrowing to cover  
deficit spending, were not similar to  
former Governor Davis' proposals**



# *Good feeling/Optimism*







***“Guys, don’t worry. You see me worry? It’ll be take care of. It’s a piece of cake.”***



**Governor Arnold Schwarzenegger  
commenting on concerns about growth  
of state debt under the budget  
proposal**



# The Short Run



Where Have All the  
Dollars Gone?



# Where Have All the Dollars Gone?





# Where Have All the Dollars Gone?





# Where Have All the Dollars Gone?







# Where Have All the Dollars Gone?





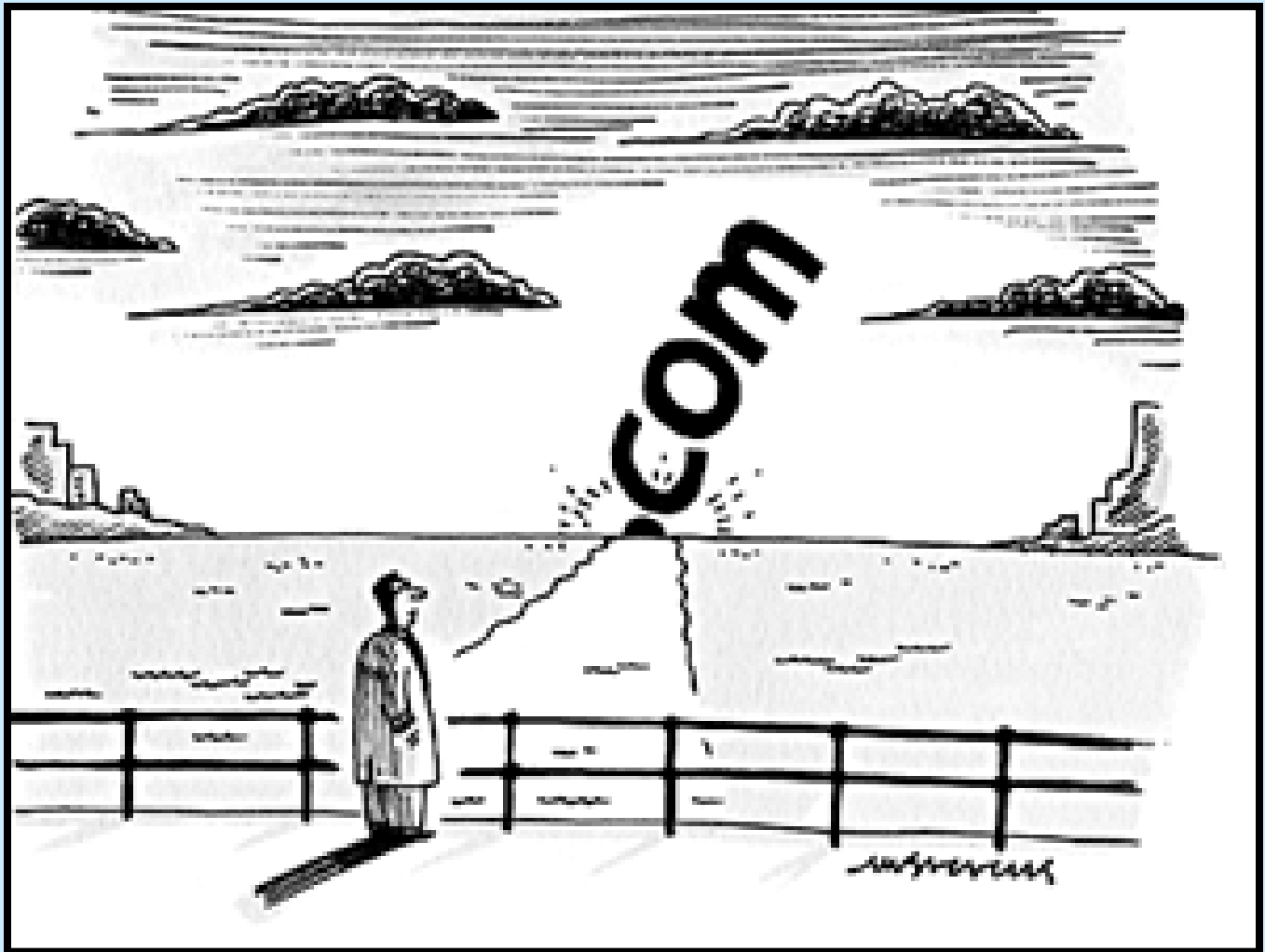
# Where Have All the Dollars Gone?





# Where Have All the Dollars Gone?





**In FY 2000-01, personal income taxes produced \$17 billion in revenue from capital gains (22% of general fund revenue).**

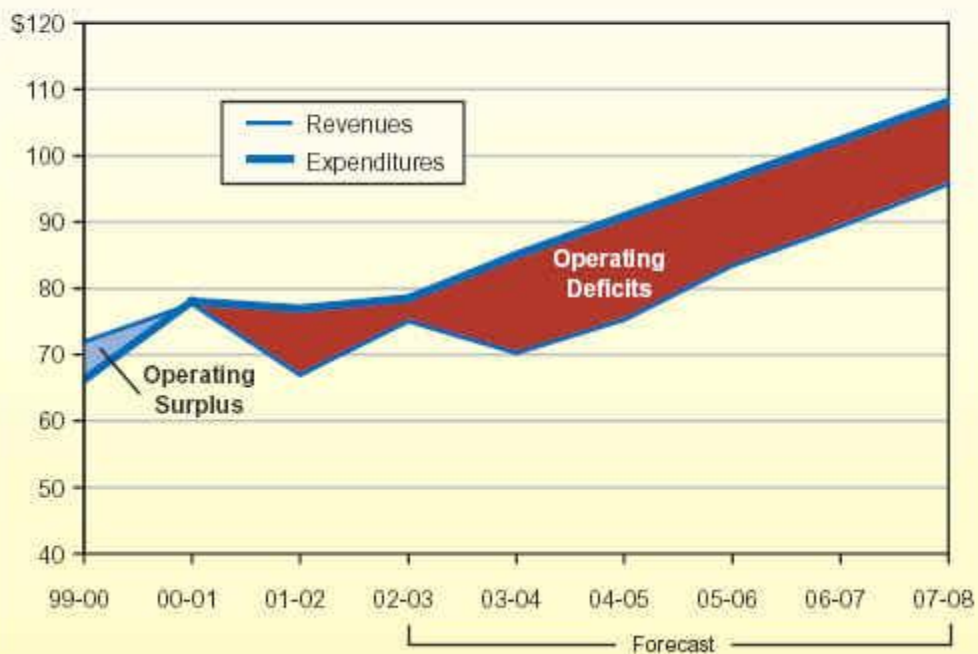


# The only thing we learn from history....

Figure 3

## Current Law Operating Deficits to Persist

General Fund  
(In Billions)



**LAO: November 2002**

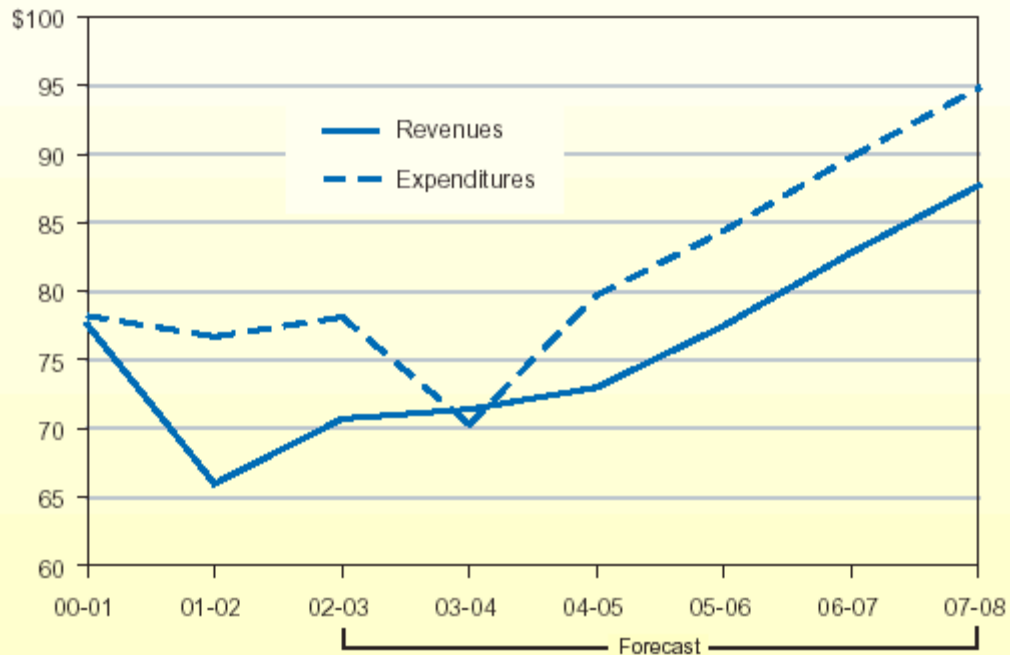


# The only thing we learn from history....

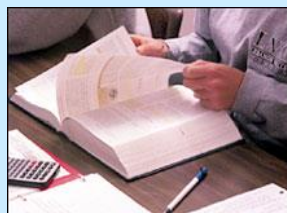
Figure 7

## Persistent Gap Would Reemerge Under Governor's Plan

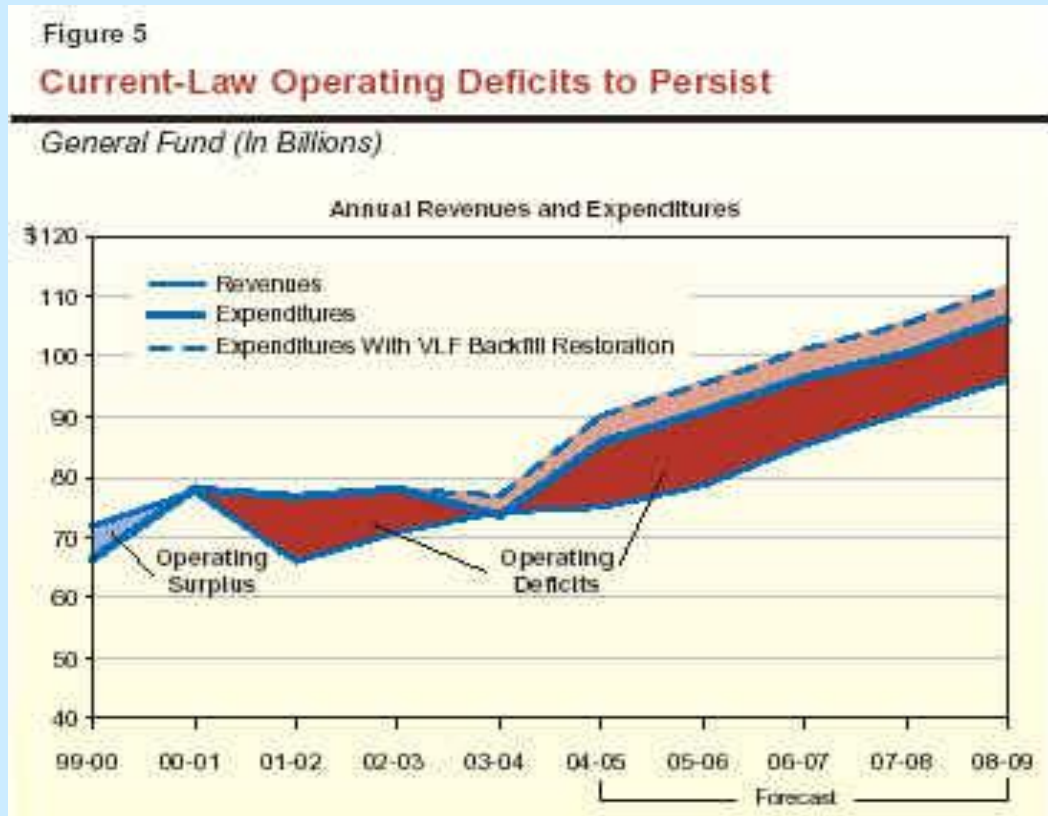
General Fund  
(In Billions)



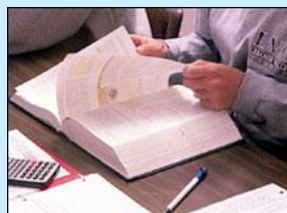
**LAO: May Revise 2003**



# The only thing we learn from history....



**LAO: November 2003**



***“We have a great budget.  
The May revise is really  
spectacular.”***



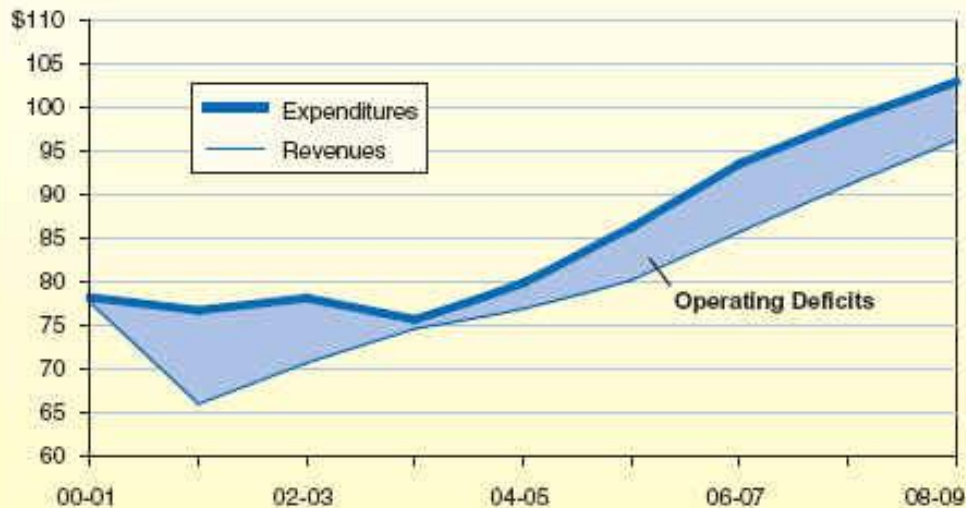
**Governor Arnold  
Schwarzenegger  
describing his May revise  
budget proposal**

# The only thing we learn from history....

Figure 12

## Large Operating Shortfalls to Persist Under May Revision<sup>a</sup>

General Fund  
(In Billions)



<sup>a</sup> LAO estimates. Excludes proposed use of Economic Recovery Bond proceeds.

## LAO: May Revise 2004



# Structural deficit



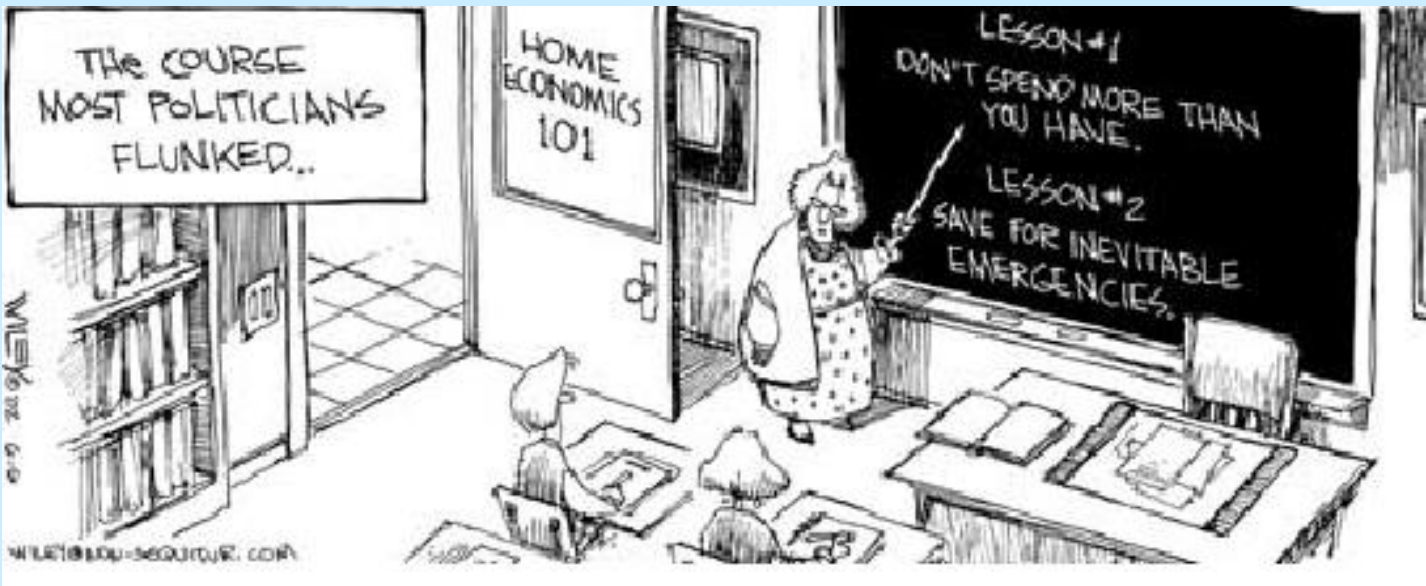
# ***Risks in the budget***



- Some borrowing may face legal challenge (pension bonds, Indian bonds)
- Some revenues may not appear
- Unpleasant cuts have proved difficult and are sometimes abandoned
- Legislature now accustomed to idea that crises can be avoided through borrowing







**Why does California  
feel exempt?**



# ***Risks in the budget***



## **Inherent California optimism?**



# ***Risks in the budget***



- Belief in the Too Big to Fail hypothesis

*“If California were a country...”*

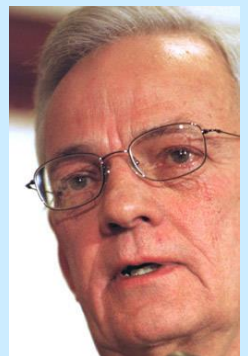
- New concept: Faith-based budgeting?



***“Reagan proved  
deficits don't  
matter.”***



**VP Dick Cheney to  
(later-fired) Treasury  
Sec'y Paul O'Neill**



# ***Problem: California has no Alan Greenspan***

- **There is no  
California  
currency**

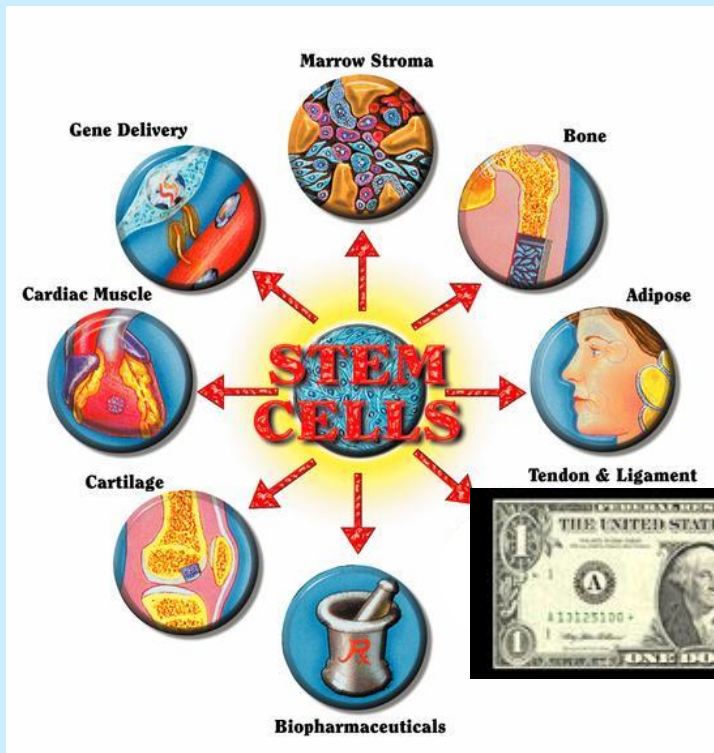


- **Its govt.  
can't run big  
deficits for  
long periods**





# If we can't print money...

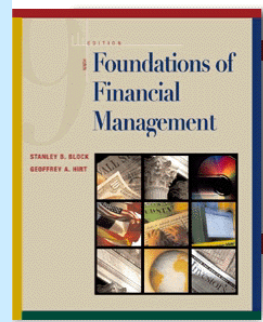
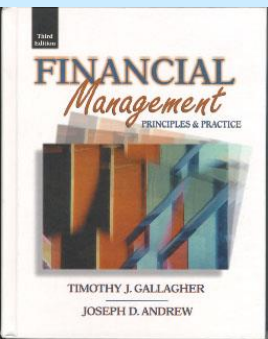


*...maybe we can clone it!*

Prop 71,  
Nov. 2004



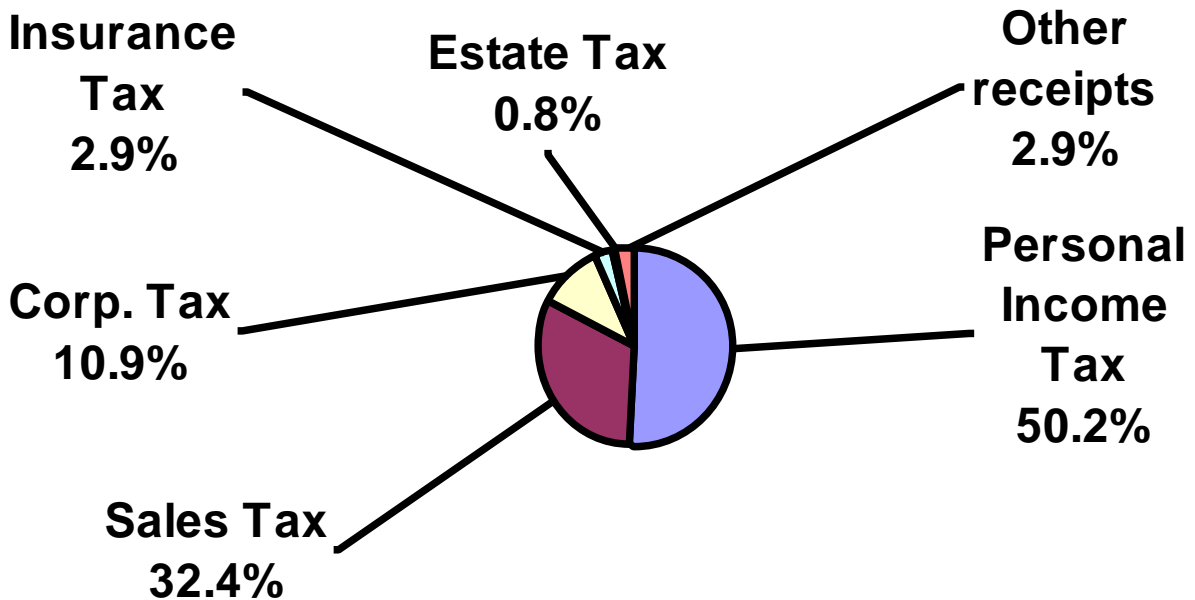
# Governor on vetoing AB 2435 mandating teaching financial management to school children...



*“Although I am unable to support this legislation, I agree with the importance of learning to spend wisely and properly manage finances... I would welcome future legislation that requires all members of the State Legislature to complete a course in financial management and responsibility.”*

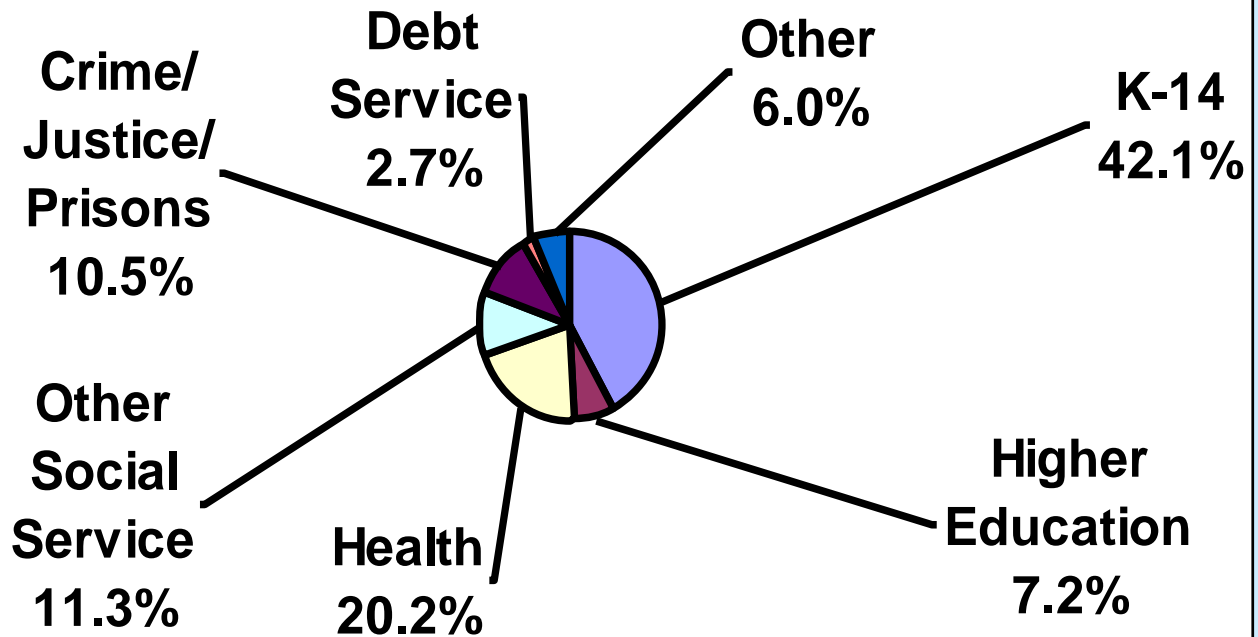
# *Budget Structure*

## **GF Cash Revenues: 2003-04** *(excluding tobacco bond)*



# *Budget Structure*

## GF Expenditures: 2004-05



# The Age of Compacts

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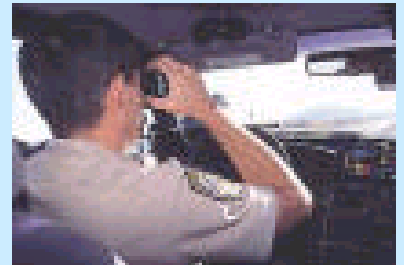


budget

# The Age of Compacts

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- **K-12 Calif. Teachers Assn.**
  - Prop 98 floor
- **Indian Gambling**
  - Federal & state legislation
- **Local Governments**
  - Prop 65 bargaining chip
- **State Employees**
  - Pre-existing collective bargaining contracts
- **Higher Education**
  - ???





***“The University of California and California State University systems went in like sheep carrying their own scissors.”***



**State Senator Sheila Kuehl**

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***“We believe we had to stop the bleeding. We did it because we felt it was the best of the options we were looking at.”***

**UC VP Larry Hershman**

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***“He looked (UC President) Bob Dynes and me in the eye and he said, ‘I will keep my commitment.’ And that’s all I need.”***

**CSU Chancellor Charles Reed**

# *Why the gridlock?*

**Why can't  
we all just  
get along?**

**Rodney King**



# Who are the parties to the “dispute”?

- **Legislature**
- **Governor**
- **Interest groups**
- **Electorate**



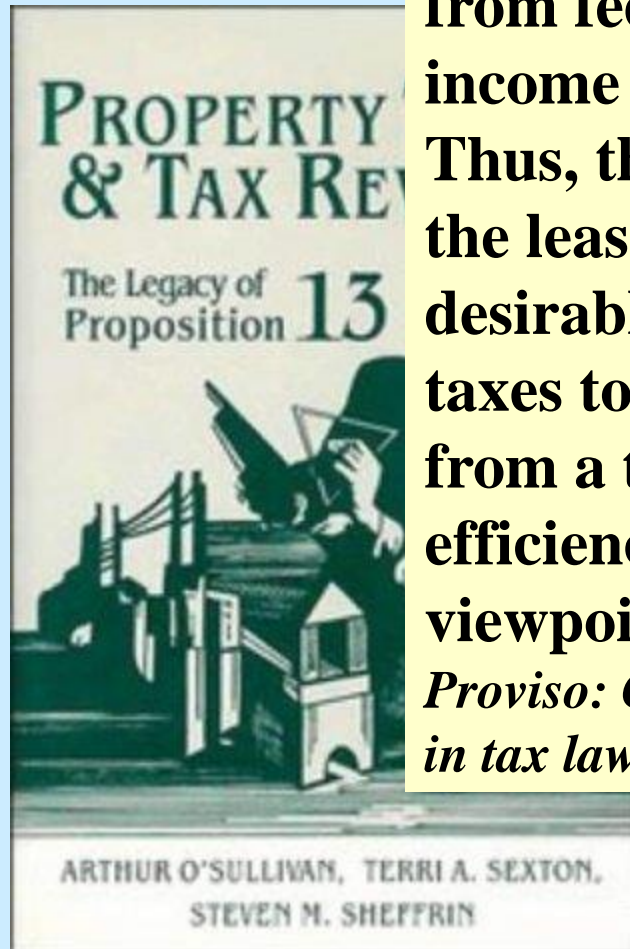
# **Howard Jarvis and Paul Gann celebrate**



**Passage of Prop 13  
(1978)**



## Numerous Studies



Note that both property and car taxes are deductible from federal income tax. Thus, they are the least desirable taxes to cut from a tax efficiency viewpoint. *Proviso: Changes in tax law, 2005.*

**Question:** Why was the *property tax* the focus of the taxpayer revolt?

**Related Question:** Why was the *car tax* such an issue in the recall?





## **BOTTOM LINE QUESTION:**

**No new  
taxes!**



***Why do we still have a  
taxpayer revolt?***

# *Transportation*

- **Special funds & GF to receive \$6.9 billion in motor-vehicle related tax**
  - Fuel taxes
  - Registration, weight, license, etc.
- **Transportation budget is \$4.9 billion of which \$1.2 billion is to be from an Indian bond**



# Gov. Olsen dedicates Arroyo Seco Parkway



...later known as the  
Pasadena Freeway





# *Earl Warren*



# *1940s Legislature*

**“How are you today  
Mr. Legislature?”**



**Arthur H. Samish** ●

*Collier's*, August 1949



# *Building of Lakewood, California*



Annual rate of  
growth:

Calif.: 4.4%

U.S.: 1.4%



**California Population in 1940:**

**7 million**

**California Population in 1950:**

**10.6 million**

# Revenue Source: *Gas Tax*



**Opposition from oil companies  
esp. Wm. Keck of Superior Oil**





# *Buses and Trucks*



Ken Goudy Collection



**Let cars pay for it.**

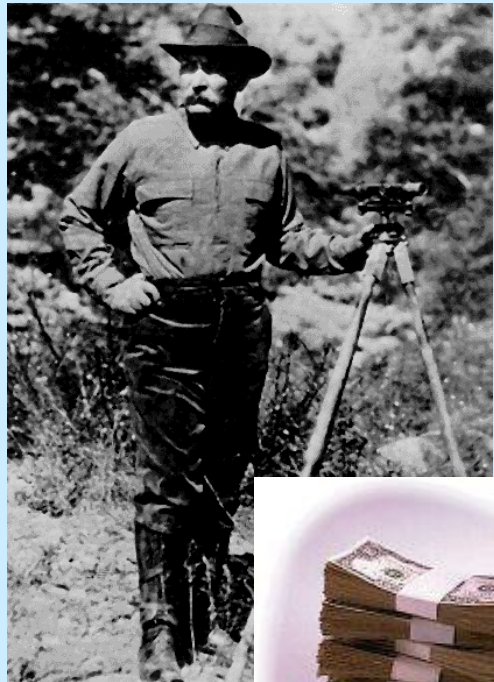


# *Collier-Burns Act* (1947)

- **Proposal: Put gas and other motor-vehicle related taxes into trust fund to avoid “diversion”**
- **Raise gas and related taxes to build freeways and other roads**

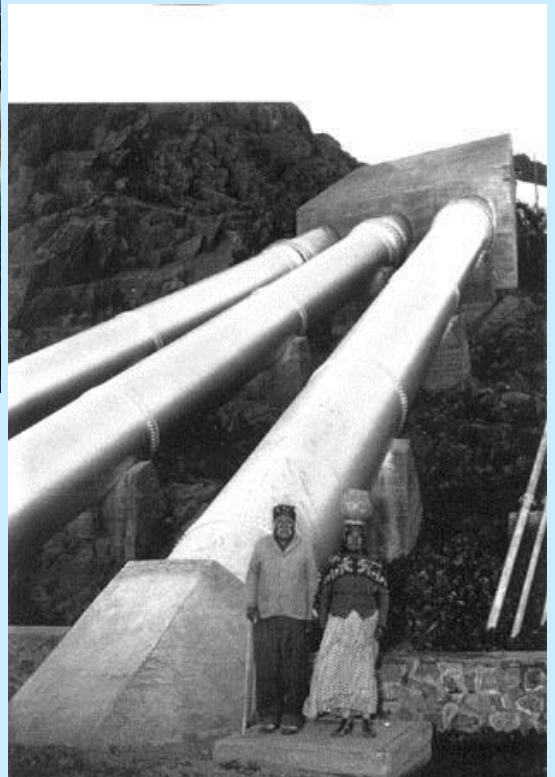


# *Owens Valley Project*





# *Colorado Water Project*



# *Master Plan for Higher Education*





## ***The California Deal: Pay ==> Get***

- **Vote bonds for water projects**
  - Get water paid for in water bills
- **Pay gas and related taxes**
  - Get roads and freeways
- **Pay state taxes**
  - Get higher education
- **Pay property tax**
  - Get schools, police, fire







## ***The California Deal Breached: Pay doesn't Get***

- **Property taxes rise rapidly in 1970s due to rising real estate values**
  - Did schools, police, fire service improve proportionately?
  - Busing controversy in LA especially SF Valley weakens link between school and property tax payer
- **Car tax increase in 2003**
  - Were new roads, etc., going to result?



# California's Current Budget Crisis: *What Can We Learn from the Past?*



## Lesson #1

The conflict is with the electorate. It's not just a matter of getting politicians to get along better in Sacramento.





# California's Current Budget Crisis: *What Can We Learn from the Past?*

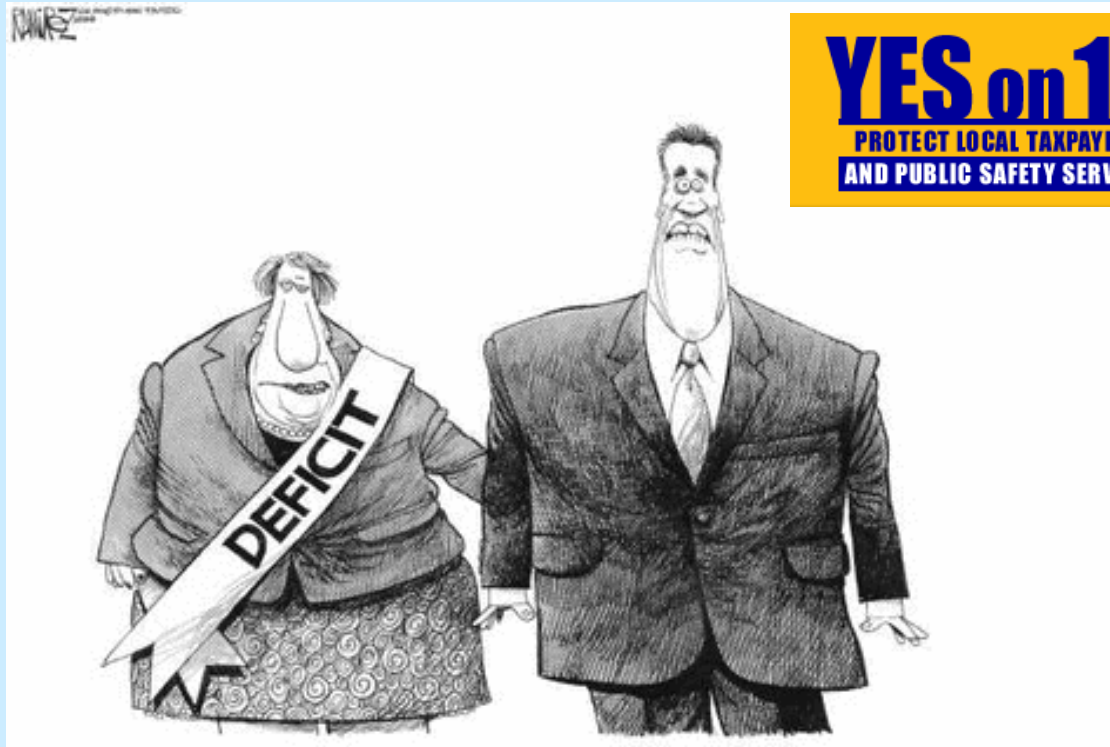


## Lesson #2

**Voters want the old California deal. Fiddling with term limits, etc., will not resolve the legislative conflict.**



# California's Current Budget Crisis: *What Can We Learn from the Past?*



## Lesson #3

**Need closer tie between taxes  
paid and services delivered.  
That implies move of revenue  
and expenditure back toward  
local govt.**



# California's Current Budget Crisis: *What Can We Learn from the Past?*

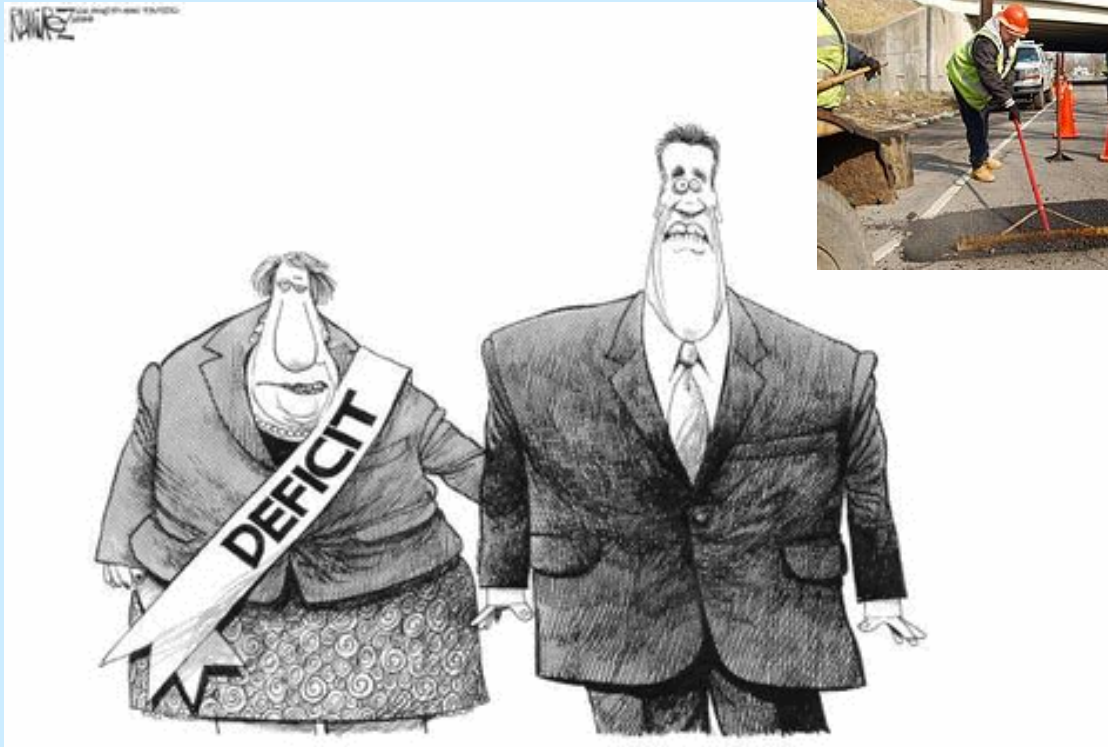


## Lesson #4

Since deal was breached, need devices to renew trust. Trust funds, earmarks, performance targets, perceived accountability, honest budgets.



# California's Current Budget Crisis: *What Can We Learn from the Past?*



## **Lesson #5 (for liberals)**

**If you want to do redistribution  
and social welfare programs,  
be sure the potholes are filled  
first.**



*And finally, now that we have some cash thanks to borrowing under Props 57/58, let's also have...*



## **Transparency in accounting to help regain public trust:**

- Distinguish stocks from flows (deficit and debt are different)**
- Consistent methodology from year to year**
- Borrowing isn't revenue**
- Expenditures can't be negative**
- Distinguish between managerial accounting and bookkeeping**





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